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SIPDIS

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TAGS: ECON EFIN EINV ETRD EPET SA
SUBJECT: SAUDI ECONOMY SHOWS MORE SIGNS OF SLOWDOWN, NO RECESSION

Classified By: Acting Deputy Chief of Mission Sandra Muench for reasons 1.4 (b) and (d)

¶1. (C) Summary: Public comments by Saudi leaders, particularly with regard to the price of oil and its effect on the Saudi economy, have become much less bullish in recent weeks as OPEC's announcements of production cuts have failed to stymie the falling price of oil. In addition, despite marginal improvements in the credit markets, significant SAMA action has done little to free up financing for major infrastructure projects. Some of these projects have either slowed or stopped as international partners had pulled out, likely due to difficulties raising sufficient funds. Saudi Arabia is likely to weather 2009 with lower growth than in 2008, but no recession, as the SAG finances government spending with surpluses left over from previous years.

Tone of public comments changes

¶2. (SBU) Over the past few months, as credit markets have remained tight and the price of oil fell, the tone of public comments by Saudi officials has changed markedly. While in September and early October most officials were saying the financial crisis would have little effect on the Saudi economy, the same individuals are now more pessimistic.

¶3. (SBU) In an unusual move, Minister of Interior Prince Naif used a GCC interior ministers meeting in Doha on November 6 to caution GCC citizens against rumors about the impact of the global financial crisis on member countries. The Saudi Press Agency quoted the Minister as saying, "We are sure our citizens will not be carried away by such rumors and that their confidence...will not be shaken."

¶4. (SBU) Oil Minister Ali Al-Naimi recently said sharp falls in oil prices have caused "havoc" with investment plans. A recent survey by the Saudi Arabia British Bank showed a 35% drop in local companies expecting growth in the first two quarters of 2009.

Falling oil prices starting to bite

¶5. (U) Despite the extremely low cost of extracting oil in Saudi Arabia, the rapid decline in the price of oil has begun to have an impact on government revenues. While 2008 will close having been a blockbuster year (publicly announced government revenue is approximately $290 billion), the just-released 2009 budget of $127 billion will be $9 billion lower than 2008 government expenditures. Moreover, the SAG anticipates a 14% budget deficit, in contrast to this year's 115% surplus.

¶6. (U) The SAG has responded to the dramatic decline in the

price of oil through both public statements and support for OPEC production cuts. King Abdallah and other high-ranking SAG officials have repeatedly said in both interviews and public speeches that a "fair price" for oil is $75 per barrel. These statements not-withstanding, the 2009 budget projects an average price of $44 per barrel.

SAMA continues to respond with fiscal measures
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¶7. (U) Saudi Arabia's central bank, the Saudi Arabian Monetary Authority (SAMA), has responded to tight credit markets with a range of measures, including lowering interest rates, lowering deposit requirements, providing banks with direct cash injections, and guaranteeing bank deposits. SAMA has lowered the demand deposit requirement from 13% to 7%, erasing four previous inflation-fighting increases, and on December 16 lowered both of their key lending rates by 0.5%, bringing the repurchase rate to less than half the level it was at four months ago.

¶8. (C) Nevertheless, SAMA's actions do not appear to be having as substantial an impact as they would like. In a December 23 meeting with Econ Counselor, SAMA Deputy Governor Dr. Abdulrahman Al-Hamidy said Saudi infrastructure projects depend on private finance for 30 - 35% of their funding, and that the international credit markets which typically provide much of this have dried up. Other officials, including Deputy Finance Minister Hamid Al-Baz'y, have echoed these sentiments, saying that while Saudi Arabia's economy will continue to grow in 2009, it will do so at a slower rate and

some projects will be delayed. Also adding to Saudi banks' difficulties, on December 18, Fitch Ratings lowered its standalone individual rating on 8 of the 11 Saudi commercial banks, making it more costly for them to borrow on the international market.

International firms back out of major projects
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¶9. (C) In the past two months, at least three major infrastructure projects have been put on hold as international firms partnered with Saudi parastatals get cold feet. First, in November, oil refinery projects in Jubail with Total and in Yanbu with ConocoPhillips were frozen, then on December 17, Rio Tinto announced it would be unable to finance its portion of a $10 billion aluminum smelter. While the SAG's official reason for these project delays has been a need to re-bid contracts to capture dramatically lower costs for materials and labor, ConGen Dhahran sources have scarce project financing and skittish foreign partners as the real reasons.

Comment

¶10. (C) Clearly Saudi Arabia's economy is not quite as insulated from the global downturn as they had hoped, particularly as slowing demand for oil has caused the price to fall precipitously. Its economy will continue to grow in 2009, but at substantially lower levels than in 2008. Government savings during recent years of windfall oil profits will allow them to finance deficit spending for 2009, largely limiting the effect of any economic slowdown on the population. The one unexpected bonus for the Kingdom is that inflation, averaging more than 9% over the first three quarters of 2008, seems to be slowing dramatically in recent months.
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